No. 96-1710

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

UNITED STATES FIRE INSURANCE COMPANY
and INTERNATIONAL INSURANCE COMPANY,

Petitioners,

—v.—

NATIONAL GYPSUM COMPANY, n/k/a Asbestos Claims Management Corporation, NGC SETTLEMENT TRUST, and CENTER FOR CLAIMS RESOLUTION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

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QUESTIONS PRESENTED

I. Whether the scope of a United States District Court's power to protect its own judgment, codified by the All Writs Act, 28 U.S.C. § 1651, includes the power to enjoin arbitration of issues previously adjudicated between the same parties by that court.

II. Whether the District Courts may properly resolve the preclusion effects of their own prior judgments, rather than leave those issues for arbitrators to decide.

III. Whether the All Writs Act, 28 U.S.C. § 1651, affords litigants a right to judicial enforcement of the preclusive effect of federal judgments, that is not waived absent clear evidence that a party has done so.

LIST OF PARENT COMPANIES AND NON-WHOLLY OWNED SUBSIDIARIES

Pursuant to Rule 29.6 Petitioners, United States Fire Insurance Company and International Insurance Company certify that their parent corporations are in ascending order as follows:

United States Fire Insurance Company:

Crum & Forster Holdings, Inc.

Talegen Holdings, Inc.

Xerox Financial Services, Inc.

Xerox Corporation

International Insurance Company:

The Resolution Group, Inc.

Xerox Financial Services, Inc.

Xerox Corporation

There are no non-wholly owned subsidiary companies of United States Fire Insurance Company or International Insurance Company.

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Petitioners, United States Fire Insurance Company and International Insurance Company ("Petitioners"), respectfully submit the within reply to Respondents National Gypsum Company's and NGC Settlement Trust's (collectively, "Respondents") Brief in Opposition to Petitioners' Petition for Writ of Certiorari.

ARGUMENT

THE CONFLICT AMONG THE CIRCUIT COURTS OF APPEALS OVER THE QUESTION OF WHETHER THE FEDERAL COURTS OR ARBITRATORS DECIDE THE PRECLUSIVE EFFECT OF A PRIOR FEDERAL JUDGMENT ON A SUBSEQUENT ARBITRATION IS BOTH A "REAL AND EMBARRASSING CONFLICT" RIPE FOR SUPREME COURT RESOLUTION AND THE QUESTIONS PRESENTED ARE NOT "HYPOTHETICAL".

Respondents dismiss as "merely an inconsistency in dicta" the clear, real and embarrassing conflict that presently exists among Third, Fifth, Eighth and Eleventh Circuits on the one hand and the Second Circuit on the other over the important question of whether a federal district court may properly inquire into, and enjoin, the arbitration of issues previously adjudicated between the same parties. Respondent argues further that Petitioner's Questions Presented I and III are merely "hypothetical" because they "improperly assume" that the district court resolved Respondent's right to bodily injury claim defense costs.

A. Petitioners' Questions Presented are Properly Before the Court And Are Not "Hypothetical"

The Questions Presented do not "improperly assume" that the district court below " 'previously adjudicated' Respondents' right to Wellington-Claims defense costs" as Gypsum contends. (Resp. Br. 7). Rather, the Questions Presented are

based on the fact that the district court specifically determined that it had adjudicated Respondents' defense costs claims under the excess liability insurance policies at issue. (*See* Pet. App. 17a).

In the district court proceedings below, Respondents conceded that the policies of excess liability insurance at issue do not treat differently property damage claims and bodily injury claims with respect to the existence or non-existence of a defense obligation under those policies. (*See id.* at 18a). Indeed, it is uncontroverted that the policy language addressing defense applies to all claims that are covered under the policies. Therefore, the fact that the court's earlier ruling in *Stonewall Ins. Co. v. National Gypsum Co.*, No. 86 Civ. 9671 (S.D.N.Y. Mar. 22, 1993) *aff'd. in relevant part*, 73 F.3d 1178 (2nd Cir. 1995) on the defense obligation issue occurred within the context of property damage claims rather than bodily injury claims was of no consequence, *unless* the Wellington Agreement somehow altered the coverage of the policies.

Upon review of the Wellington Agreement provisions that Respondents claimed manifested an insurer's consent to, or a waiver of its right to require consent to, the incurring of defense cost in bodily injury claims—Section XI ¶¶ 1 and 3—(Pet. App. 64a-65a) the district court rejected Respondents' contentions. (*Id.* at 18a-19a). The district court recognized that the Wellington Agreement merely incorporated the common law doctrine of *contra proferentum*, which holds that ambiguous policy language must be construed against the insurer. *Id.*

The district court further observed that its conclusion that the Wellington standard for establishing an exclusion for coverage was substantially the same as that of common law precepts of insurance law of the various States, and that the Wellington Agreement alters neither the construction of insurance policy coverage terms nor the legal standard to be applied in the construction of those terms was in complete

accord with the recent decision by the Court of Appeals for the Third Circuit in *North River Insurance Company v. CIGNA Reinsurance*, 52 F.3d 1194 (3rd Cir. 1995). (*See* Pet. App. 19a-20a). In *North River*, the court of appeals squarely rejected the contention advanced by Respondents that an insurer's execution of the Wellington Agreement constituted consent to the expansion of the defense obligation under its policies. (*See* Pet. App. 19a-20a).

Since that time, Respondents have understandably backed away from specifying the Wellington language it contends constitute Petitioners' "consent to, or waiver of their right to require consent to, the incurring of defense costs" (*See* Resp. Br. 2), preferring instead, to adopt what may best be described as a "somewhere in Wellington" approach to the question. However, the illogical nature of Respondents' position is perhaps best reflected in the fact that the Wellington Agreement specifically preserved all existing defense obligation disputes between insurers and their insureds for arbitration. (Pet. App. 99a-100a ¶4). Respondents have never offered an explanation as to how execution of an instrument that specifically preserves defense obligation disputes may create the very obligation that one party maintains does not exist.

Thus, the fact that the Second Circuit reversed the finding of the district court on the grounds that, in its view, an arbitrator, rather than the district court, should have made the preclusion determination, does not alter the fact that the district court made the specific finding that, in resolving the defense obligation question in *Stonewall*, the court had adjudicated Respondents' rights to defense on *all* categories of claims. (Pet. App. 17a-18a). With respect to Question Presented III, since the inception of the within action, Petitioners' have consistently argued that they are entitled to judicial enforcement of the preclusive effect of the *Stonewall* judgment under the All Writs Act, 28 U.S.C. § 1651, in the form of injunctive relief, in order to prevent Respondents' efforts at vexatious, unwarranted relitigation of the defense obligation

issues. Respondents characterizations to the contrary are inaccurate.

As set forth fully in the Petition for Certiorari, compelling reasons exist for authorizing the district court to conduct the limited threshold inquiry to determine whether or not to apply preclusion in light of the prior federal judicial judgment. Petitioners submit that, like questions of arbitrability and the arbitrability of arbitrability (*i.e.* whether the parties have agreed to arbitrate, and who decides whether they have so agreed), the preclusion doctrines are "higher-order" questions when their application implicates a prior federal judgment, because the interest sought to be vindicated by the proper application of the preclusion doctrines in that context are central to the fundamental purpose for which the civil courts were established: "the conclusive resolution of disputes"; the fostering of "reliance on judicial action by minimizing the possibility of inconsistent ruling" on the merits, and the protection of prevailing parties from vexatious relitigation. *See Montana v. United States*, 440 U.S. 147, 153-154 (1979) (Pet. Writ Cert. 14-15). Respondents offer no persuasive countervailing argument other than to cling to the general two-step arbitrability rule which does not contemplate the factual situation of a prior federal judgment.

B. The Conflict Among the Circuits is Real and Certiorari-Worthy

In an astounding exercise of sheer sophistry, Respondents argue that no real conflict exists among the circuits so as to create a certiorari-worthy conflict on the question of whether the district courts may resolve the preclusion effects of their own prior judgment, rather than leave those issues to arbitrators to decide. (Resp. Br. 10-15). Petitioners respectfully submit that the present conflict among the circuits on this issue is not only very real, but that the confusion and uncertainty reflected in the most recent cases which address this

question urgently manifest the need for guidance by the Supreme Court.

In the instant case, the Second Circuit holds that the preclusion effect of a prior federal judgment is merely an affirmative defense which, notwithstanding the implication of federal judicial action, is to be treated no differently than affirmative defenses arising solely out of the pre-litigation conduct of parties. (*See* Pet. App. 9a). In the Second Circuit's view, "issue preclusion, like other defenses to arbitrability, is arbitrable, and because issue preclusion can be arbitrated, it must be arbitrated." (*Id.* at 6a).

In contrast, the Eleventh Circuit, addressing the same issue—whether the preclusive effect of a prior federal judgment should be decided by the federal courts or left to arbitrators—and having considered the same arguments presented to the Second Circuit, held that "the better rule" is to permit the court to make the determination. "The issue," the Eleventh Circuit reasoned, "is not just one of preventing piecemeal litigation . . . but of protecting prior judgments." *Kelly v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 985 F.2d 1067, 1069 (11th Cir. 1993). Respondents seek to distinguish *Kelly* by observing that the decision involved res judicata, rather than collateral estoppel. However, Respondents offer no authority or reason to distinguish cases involving res judicata and collateral estoppel. To the contrary, in fact, courts have recognized that "the differences between [res judicata and collateral estoppel] are irrelevant" in determining whether an arbitrator is precluded from re-deciding previously adjudicated matters. *See e.g. Aircraft Breaking Sys. Corp. v. Local 856, United Auto., Aerospace & Agric. Implement Workers*, 97 F.3d 155, 161 n.2 (6th Cir. 1996) *cert. denied*, 117 S. Ct. 1311 (1997).

In *Miller Brewing Co. v. Ft. Worth Distilling Co.*, 781 F.2d 494 (5th Cir. 1986) the Fifth Circuit held that under the Federal Arbitration Act, "parties should be barred from seeking

relief from arbitration panels when, under the doctrine of res judicata, they would be barred from seeking relief in the courts." 781 F.2d at 499 (citations omitted). Respondents make no effort to distinguish this holding and the five columns of legal and factual analysis that support it, but simply dismisses the entire section of the opinion as merely a "comment on arbitrability" which may be disregarded as "dicta". (Resp. Br. 13).

The Eighth Circuit in *In re Y&A Group Sec. Litig.* 38 F.3d 380 (8th Cir. 1994) expressly followed *Kelly* and *Miller Brewing*. *See In Re Y&A*, 38 F.3d at 382 ("We conclude that the reasoning of *Kelly* and *Miller Brewing* is dispositive of the issue of the district court's power.") Citing to the *concurring* opinion, Respondents maintain that *In Re Y&A* pertains only to prior injunctions and not to other types of judgments. (Resp. Br. 12-13). The majority opinion, however, recognized no such distinction. While *In Re Y&A* involved the enforcement of a final judgment in a class action which incorporated a release and an injunction against future claims covered by the release, the majority makes clear that the existence of the injunction was not dispositive. Rather, it was "the reasoning of the [Eleventh Circuit] in *Kelly* and [the Fifth Circuit] in *Miller Brewing*" which the majority found "dispositive of the issue of the district court's power" to enjoin arbitration under the All Writs Act. *See* 38 F.3d at 382. In fact, the majority opinion consistently refers to the resolution of the prior proceeding, not as an injunction, but as a "final judgment." *See In Re Y&A Group*, 38 F.3d at 381-82.

In *Telephone Workers Union v. N.J. Bell Tel.*, 584 F.2d 31 (3rd. Cir. 1978) the Third Circuit unequivocally held that "[w]hen *a federal court* is presented with the contention that a prior federal judgment determined issues now sought to be relitigated in an arbitral forum *it must first determine the effect of the judgment*." 584 F.2d at 33 (emphasis added). Nor is *Telephone Workers* inconsistent with *Local 863 Int'l. Bhd. of Teamsters v. Jersey Coast Egg Producers, Inc.*, 773 F.2d

530 (3rd. Cir. 1985) or *Butler Armco Indep. Union v. Armco, Inc.*, 701 F.2d 253 (3rd. Cir. 1983), as Respondents contend. In *Jersey Coast*, a labor case, the court held that an arbitrator should decide whether or not an employee's prior municipal court theft conviction constituted just cause for his dismissal under the terms of a collective bargaining agreement. *See Jersey Coast*, 733 F.2d at 534. In *Butler Armco*, another labor case, the court held that an arbitrator should determine whether or not a dispute was covered by a *re-arbitration* clause in the parties' collective bargaining agreement. *See Butler Armco*, 701 F.2d at 256. Neither *Butler Armco* nor *Jersey Coast* involved the enforcement of a prior court judgment and neither decision erodes the precedential authority of *Telephone Workers*.

C. The Second Circuit's Decision is Starkly Inconsistent With the Majority of Courts That Have Addressed The Preclusive Effect of Prior Judicial Judgments On Subsequent Arbitrations.

Respondents vainly attempt to show a "trending toward agreement" among the courts of appeals "on the arbitrability of preclusion doctrines" by citing a string of inapposite cases which predominantly involve the preclusive effect of prior arbitration awards. (Resp. Br. 14). The issue of whether the preclusion principles have the same doctrinal force in arbitration proceedings as they do in judicial proceedings is not among the questions presented by Petitioners' application, and it is respectfully submitted that whatever "trends" may or may not be developing among the courts of appeals on the authority of arbitrators to decide the preclusive effect of earlier arbitration awards, those decisions are not germane to the substance of questions presented here: Whether the preclusive effect of a federal judgment issued at the conclusion of a *federal plenary trial* should be determined by the tribunal that rendered it.

In fact, contrary to the thrust of Respondents' "trending toward agreement" argument, the Seventh Circuit in *Miller v. Runyon*, 77 F.3d 189 (7th Cir.) *cert. denied*, 117 S. Ct. 316 (1996), has only recently observed that the "majority" of courts that have considered whether a judge or an arbitrator should decide the res judicata or collateral estoppel effect of a prior court judgment on a subsequent arbitration hold "that the preclusive effect of the judgment is determined by the tribunal that rendered it." 77 F.3d at 194. *In Re Y&A*, *Kelly*, and *Miller Brewing* are cited as the leading cases supporting the "majority" rule. *See id.* at 193.[1] Thus, contrary to Respondents' assertions, the Second Circuit's decision that the preclusive effect of a prior judicial judgment is merely a merits-related defense, which, like other defenses, must be arbitrated stands in stark contrast to the majority position on the question of whether courts or arbitrators decide the preclusive effect of prior court judgments.

Respondents are correct on one point: the issue presented in this case is who should decide—court or arbitrator—the preclusive effect of a prior federal judgment. (Resp. Br. 17) (Pet. Writ Cert. 6). Respondents argue, and the Second Circuit holds, that Federal District Courts must rely on arbitrators rather than on their own inherent powers codified under the All Writs Act to enforce their judgments as collateral estoppel to prevent collateral attack on those judgments by disgruntled litigants. If Respondents and the Second Circuit are

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[1] Respondents quotation from *Runyon*, intending to show a dearth of case law on the issue of whether courts or arbitrators decide the preclusive effect of prior judicial judgments, is misleading. The passage quoted by Respondents involved the courts' hypothetical of what might be the appropriate disposition of a party's request "*not to bar* but merely constrain the arbitrator . . ." *Miller v. Runyon*, *supra.*, 77 F.3d at 194 (emphasis added). The court observed that in contrast to the development of case law addressing the situation (such as in the instant case) where a party is seeking to bar arbitration, no case law had been found where a party sought merely to limit the arbitral process on preclusion grounds. *See id.*

correct on this issue, the Courts of Appeals for the Third, Fifth, Eighth and Eleventh Circuits are plainly incorrect. Either way, the conflict among the circuits is real, not illusory. Nor do Respondents dispute the confusion and uncertainty concerning these issues clearly manifest in the Sixth Circuit's decision in *Aircraft Braking Sys. Corp. v. Local 856, United Auto., Aerospace & Agric. Implement Workers, supra.*, 97 F.3d 155. Indeed, Respondents refer to the *Aircraft Braking* decision only once, in their "trending toward agreement" string citation, for the erroneous proposition that the majority of circuits hold that arbitrators "generally are entitled to determine in the first instance whether to give [ ] prior judicial determination[s] preclusive effect." (Resp. Br. 14) (quoting *Aircraft Braking*, 97 F.3d at 159 (citing *Trailways Lines, Inc. v. Trailways, Inc. Joint Council*, 807 F.2d 1416, 1425 (8th Cir. 1986) (holding that an arbitrator generally has the power to determine whether a prior [*arbitration*] award is to be given preclusive effect."))) (emphasis added). *But cf. Miller v. Runyon*, 77 F.3d at 194 (observing that the majority of cases hold that the preclusive effect of a prior judicial judgment on a subsequent arbitration is decided by the tribunal that rendered the judgment).

Thus, the presently existing conflict among the Circuits on the issue of who decides—court or arbitrator—the preclusive effect of a prior federal court judgment is both "real and embarrassing" and urgently requires Supreme Court guidance.

CONCLUSION

For all the foregoing reasons, and for the reasons more fully set forth in Petitioners' Petition for Writ of Certiorari, Petitioners, United States Fire Insurance Company and International Insurance Company, urge the Court to grant Certiorari.

Respectfully submitted,

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